

UNION EXPLORATION PARTNERS, LTD.

IBLA 88-581

Decided February 15, 1990

Appeal from a decision of the Director, Minerals Management Service, denying an appeal from an order assessing additional royalties. MMS-87-0125-OCS.

Affirmed.

1. Oil and Gas Leases: Royalties: Payments--Outer Continental Shelf Lands Act: Refunds

The offsetting of overpayments against underpayments of royalty on natural gas production from an offshore oil and gas lease may only take place after an official audit and within the royalty account of a single lease. Offsetting between leases is not permitted.

APPEARANCES: Deborah K. Cornett, Esq., Houston, Texas, for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE BYRNES

Union Exploration Partners, Ltd. (Union), has appealed from the May 24, 1988, decision of the Director, Minerals Management Service (MMS), denying its appeal of a February 6, 1987, order issued by the Regional Manager, Houston Regional Compliance Office, Royalty Management Program, directing Union to pay additional royalties of \$37,179.87 for gas produced from Well No. 22, Eugene Island, Lease No. OCS-0196, during the period July 1979 through December 1981. The order was issued as a result of a "look back" audit conducted by the Office of Inspector General (OIG) which found that Union misclassified gas from Well No. 22 as replacement/recompletion gas under section 104 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3314 (1982), when in fact the gas should have been valued at the higher NGPA section 104 biennium price(s). In its appeal before the Director and this Board, Union acknowledges the underpayment at issue, but contends that it should be permitted to offset this amount against overpayments for other leases, also discovered in the course of the audit, for which refunds cannot be obtained.

[1] Appellant's overpayments from other leases may not be refunded because section 10(a) of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1339(a) (1982), requires that any request for a refund of overpayments be

filed within 2 years of the payment. ^{1/} We have held, however, that where the Department undertakes to audit a producer more than 2 years after the excess payments at issue have been made, fundamental principles of fairness require the Department to recognize both the producer's underpayments and overpayments of royalty and to offset the underpayment by the amount of the overpayment. Shell Oil Co., 52 IBLA 74, 78 (1981). The Department has limited this exception to the offsetting of overpayments on a given lease against underpayments on that lease. Chevron U.S.A. Inc., 111 IBLA 92 (1989). For reasons discussed below, we find no reason to change the Board's ruling in this case. As this Board stated in Union Oil Company of California, 110 IBLA 62, 64 (1989):

[O]ffsetting of overpayments against underpayments may only take place after audit and within the royalty account of a single lease. Offsetting between leases is not permitted, because Federal oil and gas leases are individually assessed royalty and prudential considerations prevent crediting between leases. Mesa Petroleum Co., 108 IBLA 149 (1989); Sun Exploration & Production Co., [106 IBLA 300 (1989)].

Union's appeal "challenges the MMS procedure of selectively issuing demands for additional royalty resulting from the OIG findings in the Six-Year Lookback Audit in a manner which denies Union its ability to preserve offset rights" (Statement of Reasons at 2). In the appeal before the Director, Union had contended that all issues on the OIG lookback audit should be billed simultaneously and that Union should be permitted to offset underpayments discovered on any leases against overpayments on any other leases. The Director adhered to MMS' consistent practice of limiting offsets of overpayments and underpayments to the same lease.

The Director cited several practical considerations to support MMS' position. He first pointed out that Outer Continental Shelf (OCS) leases are separate contracts issued individually and that the royalty provisions of one lease may vary from those of another. Second, the MMS accounting system is designed to account for an individual payor on a single lease, and MMS should not be required to modify its accounting system to account on a company basis, no matter how many leases the company holds. Third, allowing offsets between OCS leases and Indian and Federal onshore leases would improperly deny Indian lessors and states their timely share of lease revenue.

^{1/} In a recent decision, Chevron U.S.A., Inc. v. United States, No. 350-87L et al. (Cl. Ct. July 24, 1989), appeal filed, No. ____ (Fed. Cir. Jan. 31, 1990), the United States Claims Court reversed this Board's determination in Shell Offshore, Inc., 96 IBLA 149, 94 I.D. 69 (1987), that section 10(a) limits the authority of the Department to refund overpayments to those requests filed with MMS within 2 years of the date of the original payment. The court found section 10(a) to be a statute of limitations and that the time period begins to run from the time the payment is determined to be excessive.

Union contends that this restricted offsetting policy violates recognized principles of fundamental fairness. Union asserts that MMS was not simply examining one lease but was verifying all royalty accounts between the parties. Union also asserts that "the MMS itself was requiring an accounting on a company basis in having the OIG engage in the Six-Year Lookback Audit" (Statement of Reasons at 6). Furthermore, Union discounts the Director's assertion that a multiple offset rule would prejudice the rights of certain beneficiaries, suggesting various alternatives by which such parties may be made whole. Union asserts that MMS' obligations to others should not be a basis for denying substantive rights due to a lessee. Nevertheless, Union would be willing to limit its offsets to OCS leases.

In Sun Exploration & Production Co., 106 IBLA 300, 303 (1989), we considered similar arguments and rejected them:

The logic and necessity for this position becomes apparent when it is recognized that the royalty payor may be an operator who is the agent for a group of lessees. Ultimate liability for any underpayment of royalty, and credit for overpayment, remains with the lessees. The extent of the interest in an overpayment which the royalty payor or operator may be entitled to claim is not shown by the record before us. The record on appeal simply does not reveal how Sun would be entitled to setoff any overpayment * * *.

Further, it is more likely than not that lessees of a lease for which royalties are overpaid will be different in identity or percentage of lease ownership from the lessees of an underpaid lease. If the right of setoff were to be allowed in the uncritical fashion advocated by Sun, the rights of the lessees entitled to credit for overpayments could be infringed. Such lessees might then claim credit to setoff their overpayments against amounts owing for other lease accounts. Since Federal royalty revenue is not uniformly distributed * * * allowance of such offsets would cause inequities for the recipients of such revenue. [Footnote omitted.]

Appellant also contends that MMS' implementation of the single lease offset policy without complying with the Administrative Procedure Act (APA) procedures violates Union's rights to due process of law. Appellant asserts that the application of MMS' "interpretive" policy directly affects its rights and obligations and has never been the subject of the notice and comment procedures required by the APA, 5 U.S.C. § 553(b)(A) (1982). In Union Oil Company of California, supra at 64, we rejected a similar argument in upholding MMS' limitation of offsets to single lease accounts:

Similarly here, the characterization of the decisionmaking by MMS as either interpretive or substantive is unhelpful to a determination whether the agency had the authority to proceed as it did, by refusing to allow credit for overpayment between individual lease accounts.

Characterization of the issue as interpretive or substantive does not further the inquiry concerning whether the MMS audit of each individual lease, which is the issue in this appeal, was correct.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

James L. Byrnes
Administrative Judge

I concur:

John H. Kelly
Administrative Judge